Macroprudential frameworks: Implementation, and relationship with other policies – Malaysia

Central Bank of Malaysia

Abstract

Given the increasing complexity and interconnectedness of the financial system, central banks have broadened their mandates and policy toolkit to address emerging risks to financial stability. This paper describes Malaysia's experience in establishing its macroprudential framework. It highlights the institutional and governance arrangements made to support decision-making, and policy formulation to avert or reduce risks to financial stability. It also discusses the importance of coordinating different policy tools, such as monetary, macroprudential and fiscal measures, to balance policy trade-offs. Drawing on Malaysia's experience in implementing household- and property-related macroprudential measures, the paper argues that recalibration of existing policies hinges on the objectives and circumstances of individual jurisdictions.

Keywords: macroprudential policy, financial stability, loan-to-value ratio

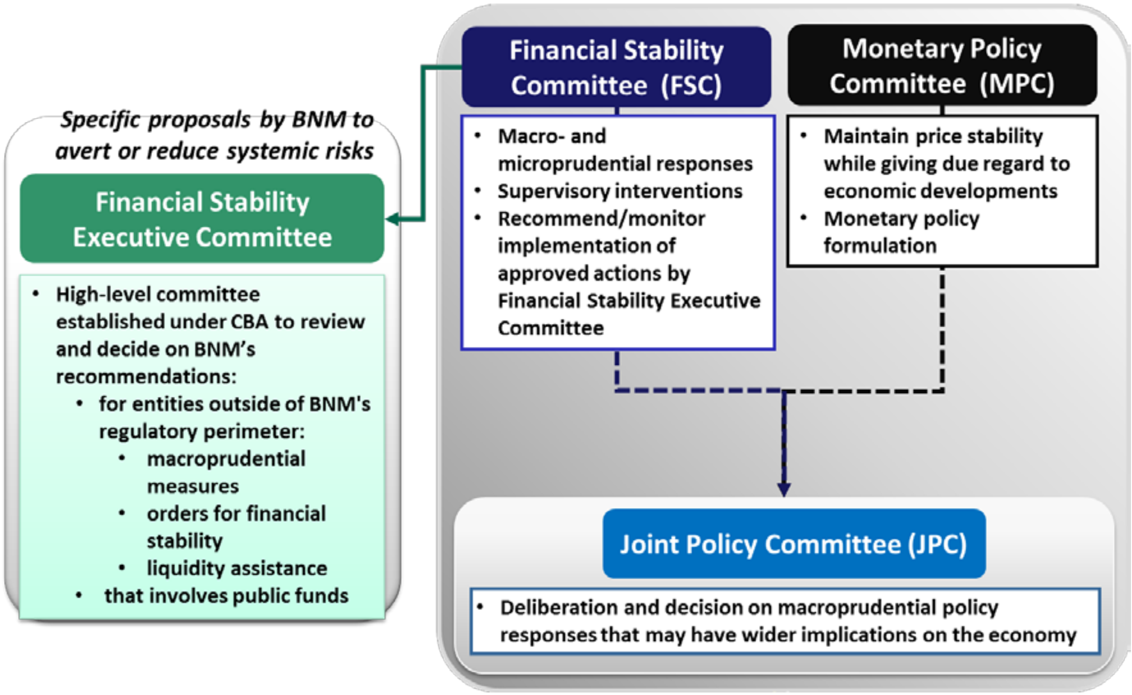
JEL classification: E58, G28

Macroprudential goals and framework

While the use of macroprudential instruments in Malaysia is not new, the enactment of the Central Bank of Malaysia Act in 2009 enhances the capacity of the Central Bank of Malaysia (Bank Negara Malaysia) to implement macroprudential policies to avert or reduce risks to financial stability. The Act provides the central bank with the autonomy to effectively fulfil its mandate of promoting monetary stability and grants powers to preserve financial stability conducive to the sustainable growth of the Malaysian economy. As the elements affecting financial stability are very diverse, establishing a comprehensive definition remains a challenging task. Malaysia therefore took the approach of defining financial stability by its risk aspects. Specifically, the Act defines "risks to financial stability" as those, which in the central bank's opinion, disrupt, or are likely to disrupt, the financial intermediation process (including the orderly functioning of the money market and foreign exchange), or affect, or are likely to affect, public confidence in the financial system or the stability of the financial system.

To ensure effective fulfilment of its financial stability objective, the central bank discharges its mandate through two internal committees, the Financial Stability Committee (FSC) and Joint Policy Committee (JPC) (Graph 1). Chaired by the Governor, the FSC meeting is held four times per year. FSC members include all deputy governors and specific assistant governors in charge of financial regulation, supervision, development and markets. The FSC serves as a high-level internal forum responsible for discussing risks to financial stability stemming from both system-wide and institutional developments, and where necessary, it decides on policy responses to avert or reduce risks to financial stability. Under circumstances where the central bank intends to apply the financial stability powers on entities that are beyond the regulatory perimeter of the central bank, or the use of public funds is required, the Act provides that such decisions are taken by the Financial Stability Executive Committee (FSEC). Chaired by the central bank's Governor, the FSEC is an inter-agency committee comprising public and private sector officials. The central bank's representation in FSEC is limited to its Governor and one Deputy Governor out of the seven members, to ensure a proper check and balance on the use of the central bank's extensive financial stability powers.

Committees in charge of macroprudential policies Graph 1



As the effects of monetary and financial stability policies interact, effective coordination between these policies is critical to achieve effective and targeted outcomes and minimise unintended consequences. The JPC was established to deliberate, decide and coordinate macroprudential policies that may have wider implications for both financial stability and the broader economy in addressing risks concerning the build-up of systemic risk and financial imbalances. The JPC consists of members from both the FSC and Monetary Policy Committee (MPC). Since its inception, the JPC has discussed and deliberated many important issues, particularly on household indebtedness and developments in the property market. With the primary goal of building resilience of financial institutions to manage systemic vulnerabilities, the JPC has implemented several macroprudential measures to address high household indebtedness and speculative behaviour in the property market since 2010.

Implementation of macroprudential frameworks: strategy, actions and tactics

The macroprudential framework in Malaysia aims to achieve an effective equilibrium between financial and monetary stability policy objectives, with the overarching objective of promoting sustainable economic growth. The calibration of macroprudential policies typically aims at addressing two main dimensions of system-wide risks, ie the evolution of systemic risks over **time** (eg risks associated with procyclicality) and the **cross-sectional** distribution of risks in the financial system (eg risks associated with concentration, contagion and interlinkages).

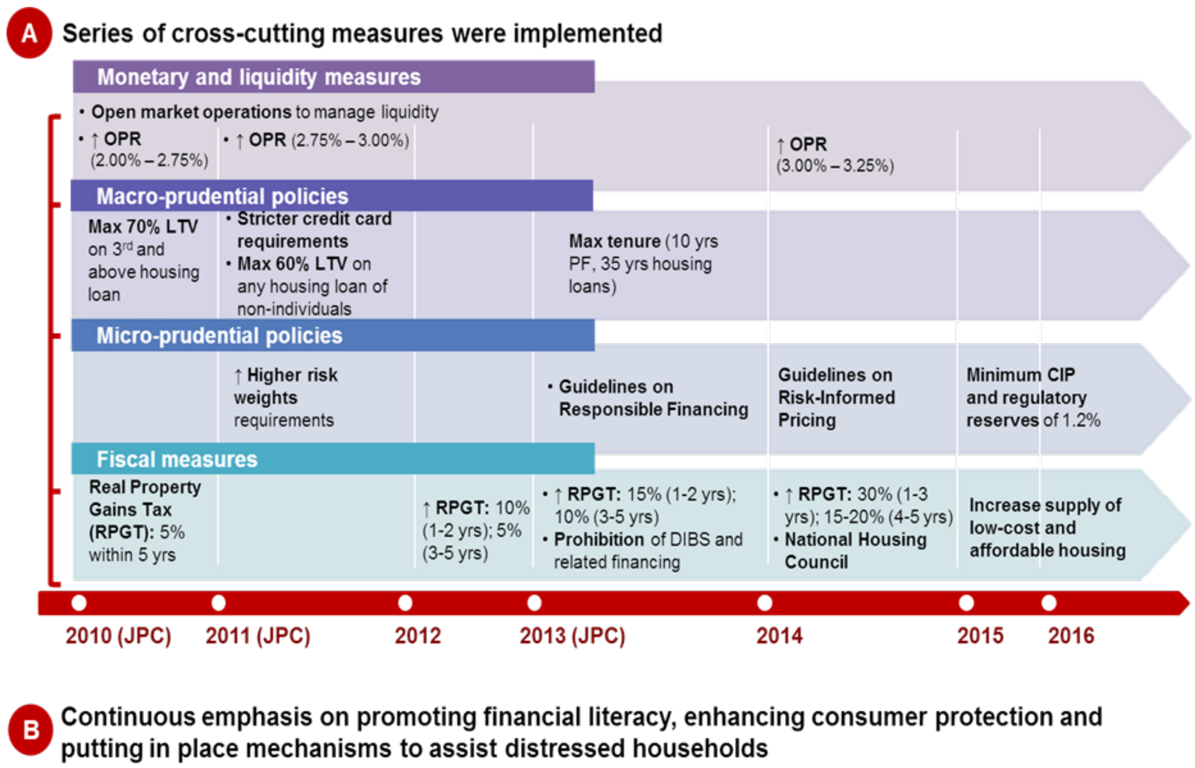
There are three key considerations in the design of macroprudential policies. First, macroprudential policies should be **discretionary**. Quantitative and qualitative assessments facilitate the task of shaping policy actions that are sufficiently pre-emptive to mitigate systemic risk, and adequately flexible to be promptly (re)calibrated or removed in response to financial sector and economic developments. Secondly, for enhanced efficacy and relevance, macroprudential policies should be **targeted** at specific segments of the financial system, ideally at the source of potential systemic risk. This keeps to a minimum the potential for over-reactions, spillovers and unintended consequences for the real economy. Finally, the design of macroprudential policies should not be considered in isolation, but **coordinated** with other policies for a holistic response. This necessitates a combination of policies – monetary, macroprudential, supervisory, fiscal and structural. To this end, the central bank has also established a culture of collaboration to benefit from the mutually reinforcing roles of macroprudential and microprudential assessments.

Recent implementation of macroprudential measures

Since 2010, the Government and the central bank had introduced a series of policy measures. These measures aimed at addressing risks that emanate from both banks and non-bank financial institutions, such as avoiding excessive household indebtedness and reinforcing responsible lending practices by key credit providers (Graph 2). The development of these measures was supported by an overlay of judgement, anecdotal evidence, and supervisory assessments – using both quantitative and qualitative information. To address potential unintended consequences (eg the migration of risks to the informal lending sector), the supervisory and macroprudential measures were also extended to non-bank financial institutions, including a building society, a retail credit provider, and credit co-operatives regulated by the Malaysia Co-operative Societies Commission. This was intended to prevent regulatory arbitrage and to ensure consistency in financing practices across all major retail credit providers. To further manage potential unintended consequences, the Bank also promoted financial education programmes to advise young and first-time borrowers on effectively managing their finances, thereby contributing to a more resilient household sector.

Underpinned by improved assessments and underwriting practices by banks and non-bank financial institutions, household debt moved onto a more moderate growth path, with continued moderation in the expansion of personal financing. As at end-September 2016, the household debt annual growth rate slowed to 5.8% compared with 14.2% at end-2010. Since the loan-to-value (LTV) ratio limits were introduced on housing loans, credit-induced speculative purchases have remained in check. This was reflected in the annual growth of the number of borrowers with at least three outstanding housing loans (a proxy for speculative purchases), which fell to around 2% from 15.8% in 2010. Housing loans settled under three years (a proxy for flipping of properties) also remained contained, at 12% of total cases. The LTV ratio measure, however, was susceptible to circumvention and operational challenges. Following the introduction of the LTV ratio limit of 70% for the third and subsequent outstanding housing loan for individuals in November 2010, the central bank observed an increase in housing loans by non-individuals – which could be individuals circumventing the measure by obtaining financing under a company's name. In response, in December 2011, the central bank introduced a maximum LTV ratio limit of 60% for all housing loans by non-individuals (see Appendix 1 for a list of measures to address household indebtedness).

Policy measures introduced since 2010 Graph 2



When it comes to removing macroprudential measures, the timing is guided primarily by whether the intended outcomes have been sustainably achieved, hence avoiding a premature exit or prolonging measures that could encourage the build-up of new risks. In determining whether to remove or recalibrate measures, there is a need to anticipate and manage potential circumvention, inadvertent spillovers or shifting of risks to other sectors. To this end, continuous monitoring of macroeconomic and financial indicators are important to assess effectiveness of macroprudential measures. For example, in reviewing the effectiveness and potential removal of macroprudential measures related to household indebtedness, the central bank monitors and assesses, among other indicators, financing trends (including access to financing) by banks and non-bank financial institutions, the asset quality of underwritten exposures, and house price growth. The central bank assessed that implementation of such measures has not affected eligible first-time home buyers or genuine long-term investors. These measures are currently still in place as part of prudential regulation, given the intended objectives of promoting prudent practices and curbing speculative purchases. In instances where macroprudential measures were introduced as part of a broader package or coordinated across countries (eg the announcement and subsequent removal of the blanket deposit guarantee by HKMA, MAS and the central bank), the timing for the removal of measures would also be subject to collective judgment and resolve.

Communication and cross-border issues

Clarity in communication is key in the deployment of macroprudential policy tools and contributes to its effectiveness. Communication strategies should be considered during the policy formulation and implementation stages. For example, following the issuance of the Guidelines on Responsible Financing, which was also extended to financial institutions outside the regulatory perimeter of the central bank, the central bank engaged with relevant consumer and industry associations, other regulatory authorities as well as officials from relevant government agencies to improve awareness of macroprudential issues, and insuring their support for the measures to be implemented.

A range of other communication tools (eg periodic reports, policy statements, press releases, speeches and interviews) are used to inform the public of the policy stance and objectives and where appropriate, encourage adjustments in the behaviour of market participants. For instance, given recent developments in the Malaysian financial markets, the central bank has continuously engaged with participants (eg banks and fund managers) to communicate and clarify its actions. Several statements were also released to provide greater clarity to and instil confidence in the markets and public. Several helplines were established to answer questions from the public. That said, the communication strategy remains a challenge. When economic conditions are less buoyant, stakeholders may press for macroprudential measures to be removed or recalibrated. Communication strategies also have to be adjusted to different scenarios, taking into account changes in the effects of the measures under prevailing economic and financial conditions.

Appendix 1

List of measures introduced by the central bank

Purpose	Introduced by the Central Bank of Malaysia	Nature of measure	Effective date
Promote responsible financial behaviour among borrowers and credit providers	Stricter credit card requirements: The minimum income eligibility for new cardholders is set at RM24,000 per annum with minimum age of 21 years; Cardholders earning ≤RM36,000 per annum can only hold credit cards from at most two issuers and the maximum credit limit extended to a cardholder shall not exceed twice monthly income per issuer	Macroprudential	Mar 2011
	Guidelines on Responsible Financing to promote prudent credit underwriting and affordability assessment (similar requirements extended to co-operatives and MBSB)	Microprudential	2012
Ensure prudent expansion of credit to households	Maximum financing tenure of 10 years for personal financing and 35 years for the purchase of residential and non-residential properties	Macroprudential	July 2013
	Prohibition on offering of pre-approved unsolicited personal financing products, and new personal financing products or variations to existing products must receive prior approval from the Bank	Macroprudential	July 2013
Promote sustainable property market and curb speculative activities	Maximum loan-to-value ratio of 70% for the third and above outstanding housing loan for individuals and 60% for housing loans by non-individuals	Macroprudential	Nov 2010 and Dec 2011
	Prohibit financial institutions from financing new development projects and end-purchases of properties with elements of interest capitalisation schemes (ICS), including developer interest bearing schemes (DIBS) or any permutations thereof	Macroprudential	Nov 2013
Enhance financial institutions' capacity to manage rising exposures to households	Guidelines on Risk-Informed Pricing to ensure pricing of retail financing products commensurate with risks assumed	Microprudential	2014
	Minimum collective impairment provisions and regulatory reserves of 1.2% of total outstanding loans, net of individual impairment provisions, to further strengthen buffers against potential credit losses	Microprudential	2015
Enhance households' capability to make informed financial decisions initiatives	POWER! Programme targeted at young adults, first time borrowers and private and public sector employees to provide practical financial knowledge, skills and tools to make sound and responsible borrowing decisions	Education and awareness	Ongoing
	Education programmes via mainstream (including radio) and social media	Education and awareness	
	Integration of financial education elements into core subjects of school curriculum (primary school: 2014; secondary school: 2017)	Education and awareness	2014 onwards

List of measures introduced by the government (cont)

<table>
<tr><th>Objective</th><th>Introduced by the government</th><th>Effective date</th></tr>
<tr><td rowspan="6">Curb speculative activities in the property market and promote affordable housing to ease upward pressure on house prices due to structural mismatch</td><td>More stringent real property gains tax (RPGT) since 2010
<table>
<tr><th rowspan="2">Disposal of property</th><th colspan="4">RPGT with effect from</th></tr>
<tr><th>2010</th><th>2012</th><th>2013</th><th>2014</th></tr>
<tr><td>Within 1st and 2nd year
(Within 1st and 3rd year)</td><td>5%</td><td>10%</td><td>15%</td><td>30%</td></tr>
<tr><td>Within 3rd and 5th year
(Within 4th and 5th year)</td><td>5%</td><td>5%</td><td>10%</td><td>15–20%</td></tr>
</table></td><td>2010 onwards</td></tr>
<tr><td>Prohibit new property development projects with elements of ICS, including DIBS or any permutations thereof</td><td>Nov 2013</td></tr>
<tr><td>Increased the floor for properties that can be purchased by non-residents from RM500,000 to RM1 million</td><td>2014</td></tr>
<tr><td>Establishment of the National Housing Council to develop strategies and action plans in a holistic manner; coordinate legal aspects and property price mechanism; and ensure provision of homes in a more efficient and expeditious manner. The Council members comprise federal agencies, state governments, National Housing Dept, PR1MA, SPNB and the private sector.</td><td>2014</td></tr>
<tr><td>Increase the supply of low cost and affordable housing
My First Home Scheme (Cagamas Berhad)
1Malaysia People's Housing Programme (PR1MA) including a rent-to-own scheme
MyHome programme
People's Housing Programme (National Housing Dept)
Various low and medium cost housing by Syarikat Perumahan Negara Berhad (SPNB)
Youth Housing Scheme</td><td>On-going (incl. Budget 2015)</td></tr>
<tr><td>50% stamp duty exemption on instruments of transfer and loan agreements for houses valued up to RM500,000</td><td>Up to end-2016</td></tr>
<tr><td rowspan="3">Provide financial assistance to targeted household sub-segments</td><td>For households with monthly earnings of RM4,000 and below: BR1M, SARA 1Malaysia</td><td rowspan="3">2012 onwards</td></tr>
<tr><td>Schooling assistance and book vouchers</td></tr>
<tr><td>Improving remuneration structure for civil servants and restructuring of annual pension scheme for retired civil servants</td></tr>
<tr><td rowspan="2">Improve public transportation system, hence reducing need for private motor vehicles</td><td>Enhance the urban public rail transportation over the medium and long term, such as the Sungai Buloh-Kajang MRT line, and extending the current Kelana Jaya and Ampang LRT line.
(Budget 2015: Construction of Second MRT line from Selayang to Putrajaya, and LRT 3 project to link Bandar Utama to Shah Alam and Klang)</td><td rowspan="2">Ongoing</td></tr>
<tr><td>Initiatives to improve and integrate bus and other transportation (esp. within the city centre), and construction of new highways and expressways (Budget 2015).</td></tr>
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